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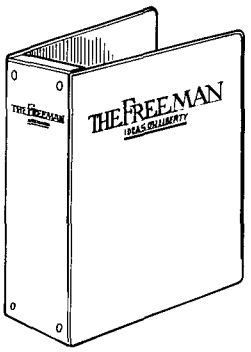

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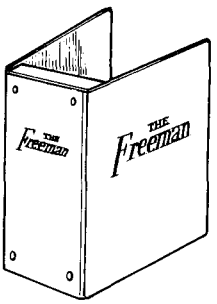

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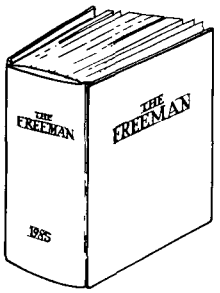

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The Privatization Revolution

John Naisbitt's new book on ten trends shaping our future, *The Year Ahead: 1986*, identifies a very old idea whose time has come: "In the year ahead, the reprivatization of America will become a swollen tide of private industry rushing in to fill the gaps left by federal government budget cuts, local governments' inability to finance basic public services, and consumer demand for quality service and greater accountability."

In fact, from Great Britain to Brazil, and including a great many third world countries, a privatization revolution is forcing the return of nationalized industries to the private sector. This is not an example of a change of heart on the part of government policy makers, merely the inexorable lesson of economic law: government interventionism doesn't work.

Privatization may presage an explosion of entrepreneurial effort and the kind of economic growth the world needs. Governments may not abolish enough of the regulations that strangle commerce. But there is an apparent world-wide shift toward the market process. As one senior development consultant put it, "governments sometimes do the right thing, but only after they've exhausted all the alternatives."

Capitalism Wins Again

The Soviet Communist Party has had to deal with reality once again. For the third time in its history, it is preparing a new program on the goals and strategies of the Party. Between the lines, capitalism comes out a winner.

Each of the two previous Soviet programs since 1903 has become progressively less optimistic of the final overthrow of capitalism. Now the current draft to the third program criticizes capitalism because it "is constantly maneuvering to adjust itself to the changing situation."

That is precisely the point! While planners make promises they cannot keep, the free market produces. While communism and socialism move from one failed plan to another, capitalism adjusts to the changing needs and desires of consumers. While all forms of interventionism try to control everything, the market permits "anything that's peaceful." Communism, indeed any form of totalitarianism, is doomed to failure because it cannot cope with change. Only freedom and a market society encourages diversity, freedom, and economic progress.

Discovering Property Rights

Bill Landreth, the teenage author of *Out of the Inner Circle*, gives us a glimpse of how property rights naturally evolve in society. He tells the story of a group of brilliant computer "hackers" who anonymously discover each other, expand their own knowledge of computer systems, and find their way into highly secret and private computer systems.

Admittedly, much of what the Inner Circle hackers did was quite wrong (breaking into other people's computer systems, for example). At the same time, Landreth gives a fascinating account of how they developed "an unwritten code of ethics that became a philosophy holding the Inner Circle together." Landreth concludes, "We had many good reasons to follow these basic rules. But the most im-

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portant . . . had to do with the basic principle of respecting other people's property and information."

These bright young men discovered on their own something they probably would never have stumbled across in school: clearly defined property rights are essential for a moral society to operate. —*GFR*

Seatbelts

We have invented a new victimless crime that is sparking a groundswell of opposition—driving without a seatbelt. A number of people are convinced that seatbelts save lives, and they presumably would buckle up whether or not the law required it. But others are impressed by the occasional accident in which an unbuckled person survives by being thrown clear.

The issue is not, of course, whether statistics prove that seatbelts reduce accidents. The issue is the right of individuals to evaluate risks for themselves. Is it a proper function of government to forcibly decide such issues for us? For a growing number of people, mandatory seatbelt laws are the equivalent of Prohibition in the twenties. And we all know what a success that was. —*JKT*

Thirty Years Ago

In the February 1956 *Freeman*, we ran an article by Ludwig von Mises on "Facts About the 'Industrial Revolution'." He showed how "The Laissez-faire ideology and its offshoot, the 'Industrial Revolution' blasted the ideological and institutional barriers to progress and welfare." What Mises wrote then is still sadly true: "There are millions and millions of people for whom there is no secure place left in the traditional economic setting. The fate of these wretched masses can be improved only by industrialization. What they need most is entrepreneurs and capitalists."

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THE FREEMAN
IDEAS ON LIBERTY

CONTENTS
FEBRUARY
1986
VOL. 36
NO. 2

41 **Perspective**

44 **Government, the State and Private Property**
by Kenneth McDonald
The State is intent on taking away private property. Despite its faults, representative government protects freedom and independence.

46 **The War on Poverty Revisited**
by Edmund A. Opitz
A unique perspective on the creation of wealth and its impact on living standards. Capitalism set in motion the productive means by which people can rise above poverty.

52 **The Constraints on Helping**
by Charles Murray
Do social programs do good? No, says the author of *Losing Ground*. In a carefully constructed "thought experiment," he illustrates his contention that they produce net harm instead.

62 **Consumers, Not Special Interests**
by Dean Russell
Special interest laws plunder all consumers, including the people who receive the government's help. Three types of such interventionism are discussed.

66 **Free Trade and Prosperity**
by Steven E. Daskal
Free trade is the market process on an international scale. Prosperity at home *and* abroad is one important benefit arising from open markets.

74 **A Reviewer's Notebook**
by John Chamberlain
A review of FEE's most recent publication, *Liberalism* by Ludwig von Mises.

76 **Other Books**
"Competing Visions" by Richard B. McKenzie and "Discovery and the Capitalist Process" by Israel M. Kirzner

79 **To The Editor**

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Government, The State, and Private Property

"The positive testimony of history," wrote Albert Jay Nock in *Our Enemy, The State*, "is that the State invariably had its origin in conquest and confiscation."

by Kenneth McDonald

Kenneth McDonald is a free-lance writer and editor living in Toronto.

From earliest times, roving bands of warriors raided settlements, expropriated the coveted possessions, and slaughtered or dispersed the owners. Before long, the technique was modified. It was more profitable to reduce the vanquished to dependence and use them as a workforce. The conquerors established the State, with themselves as aristocracies.

Western man's attempts to limit the State's power brought representative Government. Its purpose was to secure unalienable rights, a very different concept from that of the State, which admitted no rights other than those it chose to grant.

Between those two concepts, the struggle is endless. The State shows no sign of withering away. Today's aristocracies exercise power in subtler ways. By influencing the political process they subordinate Government to the State.

Here we draw a distinction between sectional interests, whose endeavors to swing things their way are, however discriminatory in effect, a legitimate part of representative Government, and the social engineers whose aim is to reshape society. Their instrument is the State.

Let us call them planners. They and their adherents share a characteristic that is both human and paradoxical: the sin of pride. The paradox consists in the fact that the planners are highly educated and articulate, yet so rooted in their convictions as to be blinded to the humanity that destines them to err.

No doubt acceptance of one's failings is an ingredient of maturity. It inspires astonishment that any combination of people could be so credulous as to think that other people—the planners—who are every bit as fallible as they, could spend their money and otherwise arrange their affairs to better purpose than they could on their own.

Unfortunately, the failings that breed maturity in others leave the planners untouched. If people do not behave the way they are supposed to, the plans may have to be modified here and there but the principle still stands: the economic forces of society are amenable to planning that is directed by people like themselves.

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Failure to question the principle stems from its adherents' failure to relate their individual fallibility to what they prescribe for others. Society is seen not as an assortment of individuals but as a coherent mass. Perfectible man will be molded by the pressures of a benevolent State. Missing from this endeavor is a recognition that people are different.

The Right To Property

At the root of all this is the matter of private property, and the right of individuals to own it. It is from invasion of that right that the State draws its power. As more and more of the right, and of the property, are transferred to the State, so does the power increase.

The conquest and confiscation in which the State originated are still in evidence. The planners may not regard themselves as conquerors but the way they have implanted their theories, and the way those theories have been communicated by education and the media, bear all the attributes of conquest. Rather than coveting possessions, the planners covet power. As the State's power expands, so does theirs.

Opposing that power is a different kind that comes from independence. Private and personal, it comes from the testing and practice of certain values. They rest upon the simple foundations of working hard and saving. Together they make possible the accumulation of capital and the security of a competence, neither of which could be achieved without the private ownership of property.

The independence that flows from these values confers not only independence from the State and its supplements but also freedom to criticize them. The planners' ideas, which look to the impersonal State for authority, are contested by other ideas that bear the authority of personal experience.

That is where the struggle is joined: between citizens who strive for the freedom they cherish, and other citizens who would whittle it down.

For all its faults, representative Government is on the side of freedom. The State is not. The ground the two struggle over is symbolized by the right to own property; the one charged with securing it, the other intent on taking it away. □

On THE STATE

IDEAS ON LIBERTY

It [the State] has taken on a vast mass of new duties and responsibilities; it has spread out its powers until they penetrate to every act of the citizen, however secret; it has begun to throw around its operations the high dignity and impeccability of a State religion; its agents become a separate and superior caste, with authority to bind and loose, and their thumbs in every pot. But it still remains, as it was in the beginning, the common enemy of all well-disposed, industrious and decent men.

HENRY L. MENCKEN, 1926

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The War on Poverty Revisited

Capitalism, by conquering poverty, creates the "problem" of poverty.

by Edmund A. Opitz

The Reverend Mr. Opitz is a member of the staff of The Foundation for Economic Education, a seminar lecturer, and author of the book, *Religion and Capitalism: Allies, Not Enemies*

If we look back over the history of the past two or three thousand years we realize that most people who have ever lived on this planet were desperately poor, not merely poor by our standards—poor by any standards; miserably housed, shabbily clothed, and continually on the verge of starvation, only to go over the edge by the hundreds of thousands during the regularly recurring famines.

Medieval Europe is regarded by many scholars as one of the high points in world civilization. It gave us the great cathedrals, scholastic philosophy, magnificent works of art, literature like Dante's *Divine Comedy*, specimens of craftsmanship that grace our museums, and chivalry. But the Middle Ages in Europe suffered from a number of famines. Between 1201 and 1600 there were seven famines, averaging ten years of famine per century. Coming down to 1709, there was a famine in France that wiped out one million people, five percent of the population. The last great natural famine in Europe was the Potato Famine in Ireland in the late 1840s, which claimed about one and a half million lives.

But Europe has always been a favored region, more properous than the rest of the world, less subject to natural disasters than Asia. There have been starving times in Western civilization, but never were they of the same order of magnitude as the disasters in the Orient. India and China have been especially vulnerable to famines. A famine in China between the years 1876 and 1879 resulted in an estimated 15 million deaths. And within living memory, a famine in China's Hunan Province in 1929 resulted in two million dead. Ten major famines in India between 1860 and 1900 caused the death of close to 15 million people. During the Bengal famine of 1943–44—in and around Calcutta—one and a half million people died of starvation and the epidemics that followed.

I have recited these rather unpleasant facts, not for their own sake, but to emphasize a neglected or overlooked truism: *Poverty is the natural state of mankind.* Poverty is the rule; prosperity is the exception. In most parts of the globe, in most periods of history—including the present—most people most of the time have been or are desperately

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poor. Prosperity is what the ruling class enjoys. The rich are the superior warriors, the superior hunters, the favorites of the gods, and these wealthy few—it was believed—deserve what they have.

Water runs downhill, fire burns, grass is green, the masses of people are poor. This was the perceived natural order of things, accepted and rarely questioned. Such was the mentality that prevailed throughout most of the world most of the time—until a few centuries ago. Poverty for the multitudes was simply a fact of life. It was a hardship, but being poor was not perceived as deprivation.

The rich were envied, but the envy rarely translated into thoughts of redistributing their wealth. Occasionally something triggered a peasants' revolt or a slave rebellion, but when each of these fizzled out, all ranks went back to "The good old rule/ The simple plan/ That they should take who have the power/ And they should keep who can." Universal poverty was a fact. But poverty was not a problem! The distinction is simple: a fact or situation just is; a fact or situation for which there is perceived to be a solution becomes thereby a problem, and a new mentality is generated.

The Capitalist Alternative

Masses of people, the world over, have now been persuaded that someone or something keeps them poor, and their resentment follows. This fact helps to explain the modern world's hostility toward capitalism. Capitalism is not at all the cause of the poverty of the noncapitalistic nations, but it is the source of their dissatisfaction with their poverty. Capitalism in fact overcomes poverty; but in overcoming poverty capitalism creates the problem of poverty.

There was a breakthrough a few centuries ago, one of those great tidal movements in human affairs resulting in a new mentality and a different way of viewing the human condition. It was the discovery by the people of a few western nations of the complex set of institutions which later came be to be called capitalism. The breakthrough might be symbolized by two documents, one penned by Thomas Jefferson setting forth the vision of a nation founded upon a new philosophy, that "all men are created equal," that they are "endowed by their Creator with certain unalienable rights," and that everyone is entitled to equal justice under the law. These axioms form the cornerstone of the free society.

At the same time, on another continent, a man named Smith wrote a great book which explained why the economy need not be centrally planned, directed, and controlled by the government—as it was under the mercantilism of his day. Let the law be vigilant to protect the life, liberty, and property of all—as the Whigs advocated—and the buying habits of freely choosing men and women in the marketplace will provide all the directives needed for the producers to grow and manufacture the things consumers want most. This is the market economy, the backbone of a free society. Under these conditions a free people will multiply their productivity and thus generate their own prosperity.

Capitalism is the name given to the set of institutions which enable free people to produce wealth up to the limit of their time, talents, capacity, and desire; and then to voluntarily exchange the fruits of their labors with others. Capitalism becomes fully operative only when there are institutional guarantees of individual liberty, with laws de-

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signed to secure the God-given rights of every person to life, liberty, and property.

The intelligent and ethical way of arranging human action in society, the free society-market economy way of life which we are labeling capitalism, was like a bootstrap by which whole nations of people could and did elevate themselves out of misery, grinding poverty, and periodic starvation. Capitalism tackled poverty using the only means by which poverty can be alleviated, namely, by increased productivity.

Remove every obstacle that hinders the productive and creative energies of men and women and you create an abundance of goods and services, shared by everyone involved according to his contribution to the productive process, as that contribution is judged by the man's peers. This ever-increasing supply of goods and services will move the entire society up the rungs of the ladder of wealth. Some will climb to the top rungs, but even the least well-off on the bottom rungs will experience a level of well-being that would be regarded as affluence in noncapitalistic societies past or present.

Liberty and the Economic Miracle

The results of this new social order were almost miraculous, but there was nothing magical about the way the results were achieved. The results were achieved by people who had the intelligence to understand the requirements of a free and prosperous commonwealth, and who possessed the integrity and character to live by those requirements. We had a significant number of people a couple of centuries ago, who "pledged their lives, their fortunes, and their sacred honor" to establish not simply a new nation, but a nation founded upon new principles.

Capitalism generated a new mentality, a new perception of the human condition. After the experience of capitalism anywhere, people everywhere came to regard prosperity as the rule; poverty as the exception. The fact that we launched a "war on poverty" demonstrates this. No one would contemplate a war on poverty in India or Africa, where need is much more desperate than here. Only in a prosperous nation like our own, where the great war against poverty had already been won—by means of the market economy—would the elimination of the last, lingering remnants of poverty emerge as a political issue. The trouble is that if we employ the wrong remedy to eradicate the remaining pockets of poverty—as we are doing—we may find that we have destroyed prosperity instead, as in the familiar story about killing the goose that laid the golden eggs. Charles Murray's recent book, *Losing Ground*, demonstrates that we have been losing the political war against poverty despite spending hundreds of billions of dollars yearly.

The 18th-century breakthrough I've referred to brought with it a new understanding of how economic goods come into being, the nature of material wealth, and how this new wealth is allocated in differing amounts among all the participants in the productive process. The economic breakthrough was not miraculous; it was preceded by a new vision of how the ancient ideas of liberty, justice, and law should be applied. No longer were these venerable ideas to be the prerogative of the few; equal justice under the law was for everyone; liberty was to be enjoyed by all, and every person had a natural right to the property created by his labor.

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For thousands of years the planet was regarded as a static warehouse, containing a fixed amount of wealth, impossible to increase, never enough for everyone. The serf tilling his field grumbled that he had to pay various feudal dues to the lord of the manor, but he was realistic enough to know that even if he kept everything he produced, he'd still go hungry much of the time. He was cursed by low productivity, caused by a faulty understanding of the nature of wealth.

When it is believed that the earth contains only a fixed amount of wealth, the preoccupation is with the allocation of what's already here, which means, invariably, that one man's gain is another's loss.

The new perception that dawned during the 18th century was that new wealth is in a process of continuous creation, in ever-increasing amounts, with more for everyone resulting from each new cycle of production. This new abundance would be distributed—not equally, but equitably—by voluntary exchanges in the marketplace, with each person receiving from his fellows what they think his contribution is worth to them. Each of us benefits in such a voluntary exchange.

This is a paradigm of capitalistic society; peaceful exchanges within the rules, with the rules designed to protect person and property. Each participant in a voluntary exchange is a net gainer, having given up what he wants less to get what he wants more. And as these exchanges multiply every person has a strong inducement to work harder, producing more of the things other people will want from him in exchange. And as each person betters his own circumstances he improves the lives of other people. Production, in a free society, begets production, with more for everyone.

In the pre-capitalistic ages the kings and nobles used their political power to enrich themselves at the expense of the peasants. The serfs who did most of the work were entitled to enjoy only a portion of the goods they produced. Post-capitalistic societies operate in similar fashion. Those who possess political power in welfarist America or socialist Britain or Soviet Russia, exercise the taxing power to deprive productive people of a huge chunk of their earnings. These tax dollars—minus the political costs of effecting these transfers—are then doled out to various "deserving" pressure groups in the private sector.

We witness what Frederic Bastiat might have called a Plunderbund—the law designed to protect life, liberty, and property perverted into an instrument to enrich some by impoverishing others. Albert Jay Nock referred to the law thus perverted as The State—holders of public office in cahoots with factions in the private sector to operate a scam against productive people.

Our basic political structures were largely built around the conviction that, "to the producer belongs the fruits of his toil." We were to have a private property order. The Declaration does not mention a right to property, substituting a right to "the pursuit of happiness." We cannot read Jefferson's mind as he wrote the document, but we do know what was in almost everyone else's mind at the time; it was Life, Liberty, and *Property*.

The colonists had migrated out of situations in Europe where they lived on the estate of a master, working mostly for his benefit and only partly for their own. Here in the colonies the idea of freehold property was established. You owned your farm in fee simple, which

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means that your estate was your very own. You could will it to your descendants, sell it, dispose of it as you wished.

What you produced on your property was yours to keep, or sell, or give away. Now, you owned what your labor created, and you had an enormous incentive to devise labor-saving devices and work harder, longer, and more skillfully because everything you produced was yours. *You* got the added benefit; not some absentee landlord. Wealth creation increased by geometrical progression under these circumstances, with free men and women living under a just system of laws, holding a strict property right in the fruits of their labor.

The American colonists of the 17th and 18th centuries lived in a society whose primary institution was not government, or the press, or business, or the academy; it was the Church. As Alexis de Tocqueville observed of us in the 1830s: "Religion . . . is the first of their political institutions." And it was the colonial churches which labored for the creation of the kind of personal character in men and women which a free society, with its market economy, demands as its basic ingredient.

We are reminded of this need for exemplary character by the late, great economist Wilhelm Roepke who said that the market economy cannot ". . . go on in a moral vacuum . . . . Self-discipline, a sense of justice, honesty, fairness, chivalry, moderation, public spirit, respect for human dignity, firm ethical norms—all of these are things which people must possess before they go to market and compete with each other." And as these early Americans entered the marketplace they practiced the Puritan ethic of work and thrift, believing that thus they served God as co-creators of a new nation, and proved that poverty is not mankind's fate.

The Wealth of the West

The Western World is relatively wealthy because it is relatively capitalistic. The Third World is poor because it shuns capitalism. This is the truth of the matter, obvious to any person who examines the issues impartially. But this truth is overcome by a worldwide ideology which declares that the wealth of the West is the cause of Third World poverty!

President Julius Nyerere of Tanzania voiced this Third World ideology when he wrote: "In one world, as in one state, when I am rich because you are poor, or I am poor because you are rich, the transfer of wealth from the rich to the poor is a matter of right; it is not an appropriate matter for charity." Along the same line, Third World voices tell us that the United States is to blame for the famine in Ethiopia—a country which *exported* its surplus grain and other foodstuffs until the Communists took over.

Third World politicians have a method in their madness: they want things from the West—American dollars, foodstuffs, machinery, and other goods—so they try to convince us that we owe it to them because we are to blame for their plight. This is the Marxist notion that the rich, under capitalism, get richer by making the poor poorer. This ploy would not work except that millions of Americans have also swallowed the Marxist exploitation theory; that those who are better off got that way by making others worse off; that the wealth created by capitalism is the cause of poverty.

Here, for example, are the words from a keynote address given at

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the World Council of Churches Assembly held in Vancouver two years ago: "We inhabitants of the industrial nations . . . exploit the majority of the world's population . . . . The demon of profit for the few at the expense of the many, i.e., their impoverishment, has the whole world economic system firmly in its grip." These false and defamatory sentiments are echoed by many academic and ecclesiastical voices, here and abroad.

Americans do consume more than most people elsewhere and it might be interesting to find out why. The answer is simple, to the point of being self-evident: Americans consume more because Americans produce more. Americans produce more, not because we are superior beings, but because our relatively free institutions impose fewer restraints on our productive energies than is the case in other nations, and our private property system guarantees to the producer that he will own the fruits of his toil. Any nation that adopts the free market will be more productive, and thus more prosperous, and in the long run this is the only way to feed the world's hungry.

A False Axiom

The redistributionist policies of our own welfare state, as well as similar international policies which tax Americans in order to subsidize other nations, is based on the false axiom that the wealth of some is the cause of the poverty of others. Something like this *was* true during the pre-capitalistic ages, but capitalism introduced an entirely new ball game in which each one of us prospers to the degree that he contributes to the well-being of other people, as they see it. Walter Lippmann puts it this way: "For the first time in human history men had come upon a way of producing wealth in which the good fortune of others multiplied their own." Freedom in production and exchange does not promise perfection. When people are free, many of their choices may offend us, which means that the free society demands infinite tolerance for each other's foibles. But that's a small price to pay for all the benefits received.

To believe that wealth is the cause of poverty makes as much sense as to assume that health is the cause of disease. And to contend that the remedy for poverty is to soak the rich and give to the poor is as idiotic as believing that the only way to heal the sick is to make the healthy ill. The sick can be made well only as they adopt the sensible regimen of the healthy, and the poor can move out of poverty only as they become more productive. The world's economic problems and other ills will only worsen unless there is a revival of that sound philosophy, which, two centuries ago, gave us the free society and the market economy which I've been labeling capitalism. Education along these lines—replacing bad ideas with better ones—is slow, frustrating, uphill work. But there is no other way.

Meanwhile, we try to live with—while working to correct—the false assumption of people everywhere, that wealth is the cause of poverty. The truth of the matter is that poverty in a nation is caused by the low productivity in that nation. And it is our good fortune that there is a simple recipe for overcoming low productivity while moving in the direction of prosperity. The recipe is: follow the prescriptions of people like Jefferson and Madison; Adam Smith, and Bastiat; Mises, Hayek, Roepke, Friedman, and others. The remedy is simple, but simple is not necessarily easy! □

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The Constraints on Helping

There are laws that explain why social programs not only *do not* but *cannot* produce the intended effects.

by Charles Murray

Charles Murray is a senior research fellow at the Manhattan Institute for Policy Research and the author of several books including *Losing Ground: American Social Policy 1950-1980* (© 1984 by Charles Murray) from which this essay is adapted and reprinted with permission of Basic Books, Inc.

Let me pose a problem in the form that Einstein used to call a "thought experiment." Whereas Einstein used the device to imagine such things as the view from the head of a column of light, we will use it for the more pedestrian purpose of imagining the view from the office of a middle-echelon bureaucrat. Our task: to think through how to structure a specific government social-action program so that it might reasonably be expected to accomplish net good.

The experiment calls for us to put ourselves in the role of a government planner who must implement a new piece of legislation, The Comprehensive Anti-Smoking Act. The Act has several provisions common to the genre. It establishes a federal agency to coordinate the federal government's activities related to the goal of less smoking. A large anti-smoking advertising campaign is planned. Federal matching funds are provided for school systems that teach courses on the perils of smoking.

In addition to these initiatives, the legislation provides for direct, concrete incentives for people to quit smoking. A billion dollars will be appropriated annually for the indefinite future, to be used for cash rewards to persons who quit. We are in charge of designing this effort, with complete freedom to specify whatever rules we wish, provided they are consistent with constitutional rights. After five years an evaluation will be conducted to determine whether the number of cigarettes consumed and the number of smokers have been reduced by the program.

The challenge in this experiment is to use the $1 billion in a way that (in our own best estimate) will meet this test. **My proposition is that we cannot do so: that any program we design will either (1) have no effect on smoking or (2) actually *increase* smoking. I maintain that we are helpless to use the billion dollars to achieve our goal.**

The heart of the problem is designing a reward that will induce smokers to quit—and will not induce others to begin smoking, continue smoking, or increase their smoking to become eligible to receive the reward. Let us work through one scenario to illustrate the nature of the conundrum.

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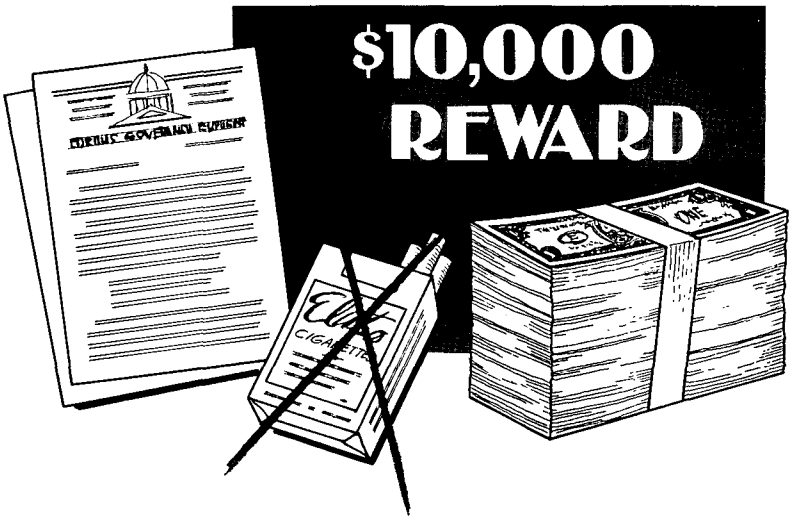

Designing the Program

Three sets of choices will decisively affect the success or failure of the program: choices about

- the size of the reward,
- conditions for receiving the reward, and
- eligibility to participate in the program.

What is a first approximation of a program that has a good chance of working?

Choosing the size of the reward. We know from the outset that the reward cannot be small. No one will quit smoking for pocket change, other than those who were going to quit anyway. On the other hand, the theoretical power of a cash reward is plausible—almost anyone would become and remain a nonsmoker in return for a million dollars. We settle on the sum of $10,000 as a reward that is an extremely powerful inducement to large numbers of persons.

Conditions for receiving the reward. We seek a middle ground between conditions that maximize the likelihood that a person has permanently quit smoking and conditions that make the reward so difficult to win that few will bother. Thus, for example, we reject plans that would spread the reward over several years. Eventually we decide to require that a person must remain smoke-free for one year. We make the award a one-time prize, so that people have no incentive to recommence smoking to qualify for another $10,000. A repayment scheme is added: People who begin smoking again will have to give up their award.

Eligibility to participate. The intent of the program is to appeal to the heavy smoker whose health is most at risk. On the other hand, it would defeat our purpose to limit eligibility too severely—to persons, for example, who have smoked three packs a day for twenty years—because in so doing we would disqualify many people in the vulnerable group of moderate smokers who are likely to become heavy lifelong smokers unless something is done. The compromise solution we reach is to require that a person have smoked at least one pack a day for five years.

Now let us consider the results.

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After one year: We think ahead a year, and are pleased. The $10,000 reward has substantial effects on the people who are eligible for the program on day one—that is, persons who have smoked at least a pack a day for five years at the time the experiment begins. The effect is not unfailing; not everyone quits smoking to get the reward; and we must assume that not everyone who stops for a year is able to avoid a relapse. Some cheating occurs despite our precautions. But some people quit smoking permanently as a direct result of the program.

We recognize, of course, that we achieve the effect inefficiently. Thousands of persons in the target population quit smoking every year even in the absence of a monetary reward. Under the program, they collect money for doing what they would have done anyway. But the problem posed in our thought experiment says nothing about being efficient; the problem is only to create a program that reduces net smoking.

After two years: We think ahead two years, and are disturbed. For now comes time to examine the effects of the program on people who have been smoking a pack a day but for a period of less than five years when the program begins.

We find that for all persons who have been smoking less than the required period of time, the program provides a payment to continue. For the person who has been smoking for exactly four years, the payment is $10,000 in return for smoking for one more year. Given that the smoking habit has its own attractions, the payment is exceedingly effective. In fact, we notice an unfortunate imbalance: For the person who has already smoked for five years (our target population), the inducement of $10,000 to quit must fight against the attractions of smoking and is not always adequate to achieve the desired result. For the smoker who has not reached this limit, the inducement to continue smoking is reinforced by those very attractions. Thus the effective power of $10,000 to induce continued smoking for one year in the one population is much greater than its power to induce cessation of smoking for one year in the other.

To this point, we have been concerned only with those who were already smoking at the pack-a-day level. Now we consider the effects of the program on smokers who had been smoking less than that amount. We find that a significant number of smokers increase their consumption to a pack a day, for the same reason. (Everyone who smokes nineteen cigarettes a day increases to twenty, almost everyone who smokes eighteen cigarettes a day increases to twenty, and so on.) This effect is strongest among those persons who think they "should" quit but who doubt their ability to quit without help. For them—through a process of plausible but destructive logic—it seems that the best way to do what they think they want to do (to quit smoking) is to smoke more.

Among those who are nonsmokers, the effects are entirely negative. A considerable number of teenagers who were wavering between starting or not starting to smoke decide in favor of smoking—they can enjoy smoking now, and then give it up when they qualify for the reward.

After five years: When we think ahead five years, we note a final logical by-product of the program. Quitting the habit after five years of smoking a pack a day is generally more difficult than quitting sooner

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and after lesser levels of smoking. Many people who try to stop when the fifth year is ended find that the $10,000 is no longer a sufficient inducement, though it may have seemed to them a few years earlier that it would be. The rules of the program have made heavy smokers out of people who would have remained light smokers and thereby have induced a certain number of people not only to smoke more and longer until they became eligible for the $10,000 but to become impervious to the effects of the reward once they do become eligible.

What is the net outcome? If 90 percent of the population had been smoking for five years when the program began, we might still argue that the program would show a net reduction in smoking. But only about 15 percent of the adult population smokes a pack a day or more. Let us estimate that a third of this number have been smoking at that rate for more than five years. If so, our plan has the potential for reducing smoking among five percent of the adult population and the potential for increasing smoking among 95 percent of the adult population. It is exceedingly difficult to attach numbers to the considerations we have just reviewed without coming to the conclusion that the program as specified would have the net effect of increasing both the number of cigarettes consumed and the number of smokers.

Back to Square One

When we reconsider the three parameters and try to select a combination that meets the challenge, the nature of their interdependence becomes clear. Suppose, for example, that we require a smoking history of at least ten years, and thereby, as intended, reduce the number of persons who are drawn into smoking just because of the reward. But such a step makes no difference in the calculations of those who have already been smoking more than five years (they are, in effect, operating under the logic of a five-year eligibility rule). Among those who have smoked less than five years, the change in the eligibility requirement has two counterproductive effects. First, persons who have smoked less than five years constitute a large proportion of smokers that the program should be reaching—younger, with more to gain from quitting. By extending the requirement to ten years, the program has been made irrelevant to many of them. For those who do think that far ahead, the effects will tend to be harmful, inducing a sense that there will be time to quit—and profit to be made—at a later point in their lives. Thus lengthening the eligibility period to ten years does not help; it makes matters worse.

As we ponder ways out of this bind, it becomes clear that the most dramatic reductions in smoking occur among persons who quit the soonest—a person who quits smoking at age sixty-five saves only a few years' worth of smoking, whereas a person who quits at twenty saves decades. Why not focus our efforts among the very young? Even granting the tendency of the award to encourage smoking so as to qualify, perhaps this will be more than counterbalanced by the very long periods of "savings" that will result from each success. So we target the program at youth (perhaps by installing an age-eligibility criterion—the specific method makes no difference). But the results are even more disastrous. The qualification criteria must be loose, because only a tiny fraction of the teenaged smokers we want to reach have had time to smoke very long. The result, when combined with

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"The burden of the smoking example is not that we failed to reduce smoking—to achieve the desired behavioral change—but that we increased the number of people who end up in the undesired condition. This charge applies to transfers in general."

a significant reward for quitting, is that the inducement effect is overpowering. Even teenagers who have no desire to smoke at all find it worth inculcating the habit for a year (or whatever our time limit is reduced to). Once started, only a proportion of those who smoked *only* because the program existed and who fully intended to quit are actually able to quit. The age effect backfires: While it is true that inducing a youngster to quit (who otherwise would not have quit) saves decades of smoking, it is equally true that inducing a youngster to start costs decades of smoking, and we produce far more of the latter than the former.

Two Ways Out

We give up on a continuing program. Instead, we propose that the program be made a one-time, never-to-be-repeated offer: Announce the program, give everyone who is *already* eligible a chance to enroll, but give no one a reason to start smoking or to increase their smoking in order to become eligible. State loudly and unequivocally that the program will never be repeated. We will at least achieve the success of the first year.

Theoretically, this scheme might (but only might) reduce net smoking. In practice, it is guaranteed that the program will be continued. A successful one-time effort will be refunded immediately and on a larger scale. Congress rarely cancels even a failed social program, let alone a successful one.

Ultimately, the logic of the situation drives us to the one configuration of awards that surely will reduce net smoking: we offer a dollar amount to everyone who does not smoke, but make them pay it back if they ever start. Since this will cost far more than a billion dollars a year, we seek permission to increase the budget, pointing out that, while it may be expensive, our way out will in fact reduce smoking, whereas the alternatives will not. But some unfriendly critic points out that all we need do is levy a fine on everyone who begins smoking (or who continues to smoke) that is equal to the reward we propose to offer for not starting. The effects on smoking will be essentially the same (a $10,000 penalty ought to have about as much effect as a $10,000 reward for persons at most income levels), and the government will get a lot of revenue to boot. This proposal is of course also rejected, on grounds that it is unfair to the poor.

As one experiments with different combinations of rules, it becomes apparent that the traps we encounter in the first approximations are generalizable. Any change in the parameters intended to reduce one

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problem raises a new one. Why should this be? Is it intrinsic to the process? Or is it a peculiarity of an example I carefully chose?

Laws of Social Programs: We cannot design programs that escape their influence.

At first glance, the smoking example seems most apt for a certain type of social program, the one that seeks to change behavior from X to Y—what might be called "remedial" social programs. But in fact it applies to transfer programs of all types. In all cases, the transfer is legitimized by the recipient's being in a certain condition (whether smoking or poverty) that the government would prefer the recipient not be in. The burden of the smoking example is not that we failed to reduce smoking—to achieve the desired behavioral change—but that we increased the number of people who end up in the undesired condition. This charge applies to transfers in general.

The reasons why are not idiosyncratic. Let me suggest some characteristics we observed in the thought experiment that occur so widely and for such embedded reasons that they suggest laws. That is, no matter how ingenious the design of a social transfer program may be, we cannot—in a free society—design programs that escape their influence. Together, they account for much of the impasse we observe in the anti-smoking example and point to some important principles for designing social programs that work.

• **#1. The Law of Imperfect Selection.** Any objective rule that defines eligibility for a social transfer program will irrationally exclude some persons.

It can always be demonstrated that some persons who are excluded from the Food Stamps program are in "greater need" than some persons who receive Food Stamps. It can always be demonstrated that someone who is technically ineligible for Medicaid really "ought" to be receiving it, given the intent of the legislation.

These inequities, which are observed everywhere, are not the fault of inept writers of eligibility rules, but an inescapable outcome of the task of rule-writing. Eligibility rules must convert the concept of "true need" into objectified elements. The rules constructed from these bits and pieces are necessarily subject to what Herbert Costner has called "epistemic error"—the inevitable gap between quantified measures and the concept they are intended to capture. We have no way of defining "truly needy" precisely—not those who truly need to stop smoking, nor those truly in need of college scholarships or subsidized loans or disability insurance. Any criterion we specify will inevitably include a range of people, some of whom are unequivocally the people we intended to help, others of whom are less so, and still others of whom meet the letter of the eligibility requirement but are much less needy than some persons who do not.

Social welfare policy in earlier times tended to deal with this problem by erring in the direction of exclusion—better to deny help to some truly needy persons than to let a few slackers slip through. Such attitudes depended, however, on the assumption that the greater good was being served. Moral precepts had to be upheld. Whenever a person was inappropriately given help, it was bad for the recipient (undermining his character) and a bad example to the community at large.

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When that assumption is weakened or dispensed with altogether, it follows naturally that the Law of Imperfect Selection leads to programs with constantly broadening target populations. If persons are not to blame for their plight, no real harm is done by giving them help they do not fully "need." No moral cost is incurred by permitting some undeserving into the program. A moral cost *is* incurred by excluding a deserving person. No one has a scalpel sharp enough to excise only the undeserving. Therefore it is not just a matter of political expedience to add a new layer to the eligible population rather than to subtract one (though that is often a factor in the actual decision-making process). It is also the morally correct thing to do, given the premises of the argument.

• **#2. The Law of Unintended Rewards.** Any social transfer increases the net value of being in the condition that prompted the transfer.

A deficiency is observed—too little money, too little food, too little academic achievement—and a social transfer program tries to fill the gap—with a welfare payment, Food Stamps, a compensatory education program. An unwanted behavior is observed—drug addiction, crime, unemployability—and the program tries to change that behavior to some other, better behavior—through a drug rehabilitation program, psychotherapy, vocational training. In each case, the program, however unintentionally, *must* be constructed in such a way that it increases the net value of being in the condition that it seeks to change—either by increasing the rewards or by reducing the penalties.

For some people in some circumstances, it is absurd to think in terms of "net value," because they so clearly have no choice at all about the fix they are in or because the net value is still less desirable than virtually any alternative. Paraplegics receiving Medicaid cannot easily be seen as "rewarded" for becoming paraplegics by the existence of free medical care. Poor children in Head Start cannot be seen as rewarded for being poor. Persons who are in the unwanted condition *completely involuntarily* are not affected by the existence of the reward.

But the number of such pure examples is very small. The paraplegic anchors one end of the continuum labeled "Degree of Voluntarism in the Conditions that Social Policy Seeks to Change or Make Less Painful." The apparent unattractiveness of most of the conditions that social policy seeks to change must not obscure the continuum involved. No one chooses to be a paraplegic, and perhaps no one chooses to be a heroin addict. But the distinction remains: very few heroin addicts developed their addiction by being tied down and forcibly injected with heroin. They may not have chosen to become addicts, but they *did* choose initially to take heroin.

Let us consider the implications in terms of the archetypical social program for helping the chronic unemployed escape their condition, the job-training program.

Imagine that a program is begun that has the most basic and benign inducement of all, the chance to learn a marketable skill. It is open to everybody. By opening it to all, we have circumvented (for the time being) the Law of Unintended Rewards. All may obtain the training, no matter what their job history, so no unintended reward is being given for the condition of chronic unemployment.

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On assessing the results, we observe that the ones who enter the program, stick with it, and learn a skill include very few of the hardcore unemployed whom we most wanted to help. The typical "success"stories from our training program are persons with a history of steady employment who wanted to upgrade their earning power. This is admirable. But what about the hardcore unemployed? A considerable number entered the program, but almost all of them dropped out or failed to get jobs once they left. Only a small proportion used the training opportunity as we had hoped. The problem of the hardcore unemployed remains essentially unchanged.

We may continue to circumvent the Law of Unintended Rewards. All we need do is continue the job-training program unchanged. It will still be there, still available to all who want to enroll, but we will do nothing to entice participation.

The alternative is to do something to get more of the hardcore unemployed into the program, and to improve the content so that more of them profit from the training. And once this alternative is taken, the program planner is caught in the trap of unintended rewards. Because we cannot "draft" people into the program or otherwise coerce their participation, our only alternative is to make it more attractive by changing the rules a bit.

Suppose, for example, we find that the reason many did not profit from the earlier program was that they got fired from (or quit) their new jobs within a few days of getting them, and that the reason they did so had to do with the job-readiness problem. The ex-trainee was late getting to work, the boss complained, the ex-trainee reacted angrily and was fired. We observe this to be a common pattern. We know the problem is not that the ex-trainee is lazy or unmotivated, but that he has never been socialized into the discipline of the workplace. He needs more time, more help, more patience than other workers until he develops the needed work habits. Suppose that we try to compensate—for example, by placing our trainees with employers who are being subsidized to hire such persons. The employer accepts lower productivity and other problems in return for a payment to do so (such plans have been tried frequently, with mixed results). Given identical work at identical pay, the ex-trainee is being rewarded for his "credential" of hardcore unemployment. He can get away with behavior that an ordinary worker cannot get away with.

May we still assume that the program is making progress in preparing its trainees for the real-world marketplace? Will the hardcore unemployed modify their unreliable behavior? What will be the effect on morale and self-esteem among those trainees who were succeeding in the program before the change of rules? It is tempting to conclude that the program has already ceased to function effectively for anyone anymore, that the change in rules has done more harm than good. But my proposition is for the moment a more restricted one: The reward for unproductive behavior (both past and present) now exists.

What of the case of a drug addict who is chronically unemployed because (let us assume) of the addiction? It might seem that the unintended reward in such a case is innocuous; it consists of measures to relieve the addict of his addiction, measures for which the nonaddict

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"Social programs in a democratic society tend to produce net harm in dealing with the most difficult problems. They will inherently tend to have enough of an inducement to produce bad behavior and not enough of a solution to stimulate good behavior."

will have no need or use. If we were dealing with an involuntary disability—our paraplegic again—the argument would be valid. But in the case of drug addiction (or any other behavior that has its rewards), a painless cure generally increases the attractiveness of the behavior. Imagine, for example, a pill that instantly and painlessly relieved dependence on heroin, and the subsequent effects on heroin use.

Thus we are faced with the problem we observed in the thought experiment. The program that seeks to change behavior must offer an inducement that unavoidably either adds to the attraction of, or reduces the penalties of engaging in, the behavior in question.

We are now ready to tackle the question of when a social program can reasonably be expected to accomplish net good and when it can reasonably be expected to produce net harm. Again let us think in terms of a continuum. All social programs, I have argued, provide an unintended reward for being in the condition that the program is trying to change or make more tolerable. But some of these unintended rewards are so small that they are of little practical importance. Why then can we not simply bring a bit of care to the design of such programs, making sure that the unintended reward is *always* small? The reason we are not free to do so lies in the third law of social programs:

• **#3. The Law of Net Harm.** The less likely it is that the unwanted behavior will change voluntarily, the more likely it is that a program to induce change will cause net harm.

A social program that seeks to change behavior must do two things. It must induce participation by the persons who are to benefit, as described under the Law of Unintended Rewards. Then it must actually produce the desired change in behavior. It must succeed, and success depends crucially on one factor above all others: the price that the participant is willing to pay.

The more that the individual is willing to accept whatever needs to be done in order to achieve the desired state of affairs, the broader the discretion of the program designers. Thus, expensive health resorts can withhold food from their guests, hospitals can demand that their interns work inhuman schedules, and elite volunteer units in the armed forces can ask their trainees to take risks in training exercises that seem (to the rest of us) suicidal. Such programs need offer no inducement at all except the "thing in itself" that is the *raison d'être* of the program—a shapelier body, a career as a physician, membership in the elite military unit. Similarly, the drug addict who is prepared to sign over to a program a great deal of control over his own behavior may

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very well be successful—witness the sometimes impressive success rates of private treatment clinics.

The smaller the price that the participant is willing to pay, the greater the constraints on program design. It makes no difference to an official running a training program for the hardcore unemployed that (for example) the Marine Corps can instill exemplary work habits in recruits who come to the Corps no more "job-ready" than the recruits to the job-training program. If the training program tried for one day to use the techniques that the Marine Corps uses, it would lose its participants. Boot camp was not part of the bargain the job trainees struck with the government when they signed on. Instead, the training program must not only induce persons to join the program (which may be fairly easy). It must also induce them to stay in the program, induce them to cooperate with its curriculum, and induce them, finally, to adopt major changes in outlook, habits, and assumptions. The program content must be almost entirely carrot.

There is nothing morally reprehensible in approaches that are constrained to use only positive inducements. The objections are practical.

First, it is guaranteed that success rates will be very low. The technology of changing human behavior depends heavily on the use of negative reinforcement in conjunction with positive reinforcement. The more deeply engrained the behavior to be changed and the more attractions it holds for the person whose behavior is involved, the more important it is that the program have both a full tool kit available to it *and* the participant's willingness to go along with whatever is required. The Marine Corps has both these assets. Social programs to deal with the hardcore unemployed, teenaged mothers, delinquents, and addicts seldom do.

Second, as inducements become large—as they must, if the program is dealing with the most intractable problems—the more attractive they become to people who were not in need of help in the first place. We do not yet know how large they must finally become. At this point, it appears that any program that would succeed in helping large numbers of the hardcore unemployed will make hardcore unemployment a highly desirable state to be in.

The Theoretical and Practical Result

The conditions that combine to produce net harm are somewhat different in the theoretical and the practical cases, but they come to the same thing. Theoretically, any program that mounts an intervention with sufficient rewards to sustain participation and an effective result will generate so much of the unwanted behavior (in order to become eligible for the program's rewards) that the net effect will be to increase the incidence of the unwanted behavior. In practice, the programs that deal with the most intractable behavior problems have included a package of rewards large enough to induce participation, but not large enough to produce the desired result.

My conclusion is that social programs in a democratic society tend to produce net harm in dealing with the most difficult problems. They will inherently tend to have enough of an inducement to produce bad behavior and not enough of a solution to stimulate good behavior; and the more difficult the problem, the more likely it is that this relationship will prevail. □

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Consumers, Not Special Interests

Consumers are harmed by all forms of special interest legislation. Three are examined here.

by Dean Russell

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We human beings have always organized ourselves into groups to increase our ability to get the goods and services necessary for survival. Even our most primitive ancestors eventually learned that production (and thus survival) could be increased by organizing and specializing.

When we use this organization for peaceful production, it usually proves successful. But when we organize to increase our possession of products by plundering our neighbors, the ultimate consequences are usually more costly than profitable.

Both of these methods for increasing our supply of products and services are still used in the United States today. When the method of voluntary exchange of goods and services is used, the results are successful indeed; production skyrockets and prosperity is widespread. But special interest groups inevitably organize to increase their share by voting for laws that compel us to pay for products and services we don't want at their "special privilege" prices.

When special interest legislation is used, when voluntary exchange is interfered with, all of us consumers are directly and indirectly harmed. Ultimately, even the special interest groups find the consequences of this approach to be more costly than profitable.

I'm here selecting three of the most familiar and harmful of these special interest laws for brief examination. They are price supports for farmers, legally imposed wage increases for employees, and rent controls for tenants.

Price supports injure us consumers by keeping inefficient producers in business, or they encourage producers to take uneconomic actions that eventually increase costs, or they directly and immediately increase the price of the supported product, or (most likely) they increase the cost to us consumers by a combination of all three categories.

Further, as is now becoming increasingly obvious, even the recipients of the price supports (the producers) are also injured—frequently to a much greater degree than are we general consumers of their products. For example, so many farmers have been literally forced into

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bankruptcy by the government's "support programs" that were supposed to help them by keeping prices higher than they would be in a market economy.

Beguiled by our government's promise to pay for unwanted production, farmers bought (or held on to) land at double and treble the price it would be in a free market; and they increased production accordingly. That, of course, only worsened a situation that had been caused in the first place by more production than we consumers would buy at prices needed to keep all those farmers in business.

In an effort to decrease the unwanted production, our government began paying farmers to keep a part of their land idle. Our government then began buying and storing vast quantities of the excess production at a cost of billions of dollars to us consumers (taxpayers). But "political considerations" forced the officials to dispose of the surplus products by giving them away to low-income groups and by selling them below cost in the world agricultural market. Both of those giveaway programs reduced the number of paying customers. That, in turn, put further pressure on the farmers to reduce prices in order to sell the products that were not bought by government but had to be sold to us consumers directly.

Eventually, of course, the economic reality of consumer demand and producer supply re-established itself in our still reasonably free economy. And the recipients of the price supports (the farmers) ended up the most injured of all. Their liabilities in debts were soon much higher than their assets in overpriced land and unreliable political promises for special treatment. They were bankrupt.

Farmers seem strangely unaware that they, too, are consumers. And as consumers, they just can't pay the artificially inflated prices for products they themselves have to buy to stay in business. When they voted for "special privilege laws for farmers," they simply ignored the connection between their price supports and the rising prices for all products and services. The consequences of governmental interventions in the market place can't be restricted to just one item or category; there's a "neighborhood effect" that inevitably affects all prices to the detriment of all consumers.

Labor Laws Decrease Productivity

Similar economic consequences also come from labor laws that interfere with the market allocation and price of that particular factor of production. Those laws usually increase the cost of labor above the market price, or decrease the productivity of labor, or both. In turn, those uneconomic political decisions cause an increase in prices to all consumers of the products and services.

Once again, the recipients of those "special interest" labor laws frequently end up as the most injured of all. They price themselves out of the market, especially the world market. Their employers move or go bankrupt. The employees then turn to their government for welfare support. And thus their economic misfortunes are compounded by loss of personal pride that usually comes from lengthy unemployment, plus the inevitable decrease in respect by many of their neighbors. That, of course, is the most destructive consequence of all.

When I buy a product, my invariable policy is to look behind the label, and to search for the best quality and lowest price. I'm not unduly interested in who produces it, or where. In fact, if it comes

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The effect of rent controls, The Bronx. P. KARAS, FPG INTERNATIONAL

from abroad at a lower price, I know that products in general are thereby *increased* for us consumers; we get the wanted product, plus the additional products we buy with the "leftover" money.

As a third example of the harm done by these governmental interferences in a market economy, consider housing. Rent controls do great injury to us consumers in general but, more likely than not, they are especially damaging to persons who live in the price-controlled apartments.

The first and immediate effect of rent controls on housing is to stop the building of new houses and apartments for rent. That's why there hasn't been a single house or apartment building constructed by private investors at rent-controlled prices in New York City since those laws were imposed "temporarily" in 1942. The reason is simple: You and I, as reasonably prudent investors, will not voluntarily agree to build products that are obviously price-limited below the market in a situation that's controlled by politicians. Those elected officials are well aware that "more tenants vote than landlords." That fact also explains why those "temporary laws" are likely to remain with us until all the buildings controlled by them finally disappear—either literally or by conversion to more profitable categories.

In an attempt to increase housing in New York, Governor Thomas Dewey sponsored a law in 1954 to permit the owners of *new* apartments to charge market prices. While that did induce new construction of apartments for rent, the continuing rent controls on all pre-war apartments contributed greatly to the near-destruction of a once-great city. Here's a personal story to show how it works.

When I first visited New York in 1937, the first bed I slept in was a sofa in the apartment of a friend living in the South Bronx. That area was a friendly and well-tended neighborhood with thousands of apartments, rented mostly to families with moderate incomes. I visited

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there again in 1948, after six years of rent controls. It was still a desirable neighborhood, but the deteriorating process had begun.

An inevitable companion of rent control is the decay of the buildings. The owners of those buildings act precisely as you and I always act with our own investments. We look for safety and a good return. And just as you and I would have done, the owners of those rent-controlled properties began to skimp on upkeep and to transfer back into a market economy whatever capital they could recover from gross income.

When that process became obvious, the tenants organized to keep the rents low and legally to compel the owners to paint and repair the buildings and to provide adequate heat during the winter. But turning to the law to force investors to spend their money uneconomically never works. Since you and I don't act that way, why do we expect the owners of rental buildings to act against their own self-interests?

In due course, the more desirable tenants began to move out of those deteriorating rent-controlled buildings in the South Bronx. Their places were increasingly taken by unemployed people existing on government welfare. That development soon induced almost all of the original tenants to move out.

Rent control laws help nobody, perhaps least of all the tenants trapped by them. Even high-income tenants frequently remain in their present locations and thus forgo more desirable jobs because of the higher rents they would have to pay if they accepted the offer of a better job and moved to another city. Anyway, rent-controlled tenants in general are increasingly being dispossessed by the owners who convert their uneconomic rental buildings into cooperatives and condominiums in an effort to get a market return on their investments.

When we turn to government to stop the voluntary exchanging of goods and services that goes on among peaceful persons in a free market economy, the process does injury to all consumers, i.e., everybody, and often literally destroys the people who receive the government's help. □

In Future Issues . . .

March

- "The Open-Endedness of Knowledge—Its Role in the FEE Formula" by Israel M. Kirzner
- "Productivity vs. Exploitation" by Henry Hazlitt
- "Who Will Control Medical Care?" by Jane M. Orient

April

- "Cyclical Unemployment" by Hans Sennholz
- "Disasters Unlimited" by John W. Sommer

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Free Trade and Prosperity: A Global Approach

International development and domestic prosperity are ensured by free trade.

by Steven E. Daskal

Mr. Daskal of Annandale, Virginia, is a defense systems analyst and writer.

Americans are especially prone to feel obligated to help others on a global scale. Whether it is the unfortunate plight of our fellows in the under-developed nations, often known as the "Third World," or the difficulties and unemployment facing some Americans at home, we care. Within that context, free trade is a vital issue, because it is one of the primary means by which the market economy helps create global prosperity.

When surveying the world economic situation, some Americans feel guilt over our comparative wealth and comfort in contrast to the millions living at the subsistence level. Our size, power, and wealth appear to some as being of little value unless we use that wealth to help the less fortunate. We send food, money, training advisors, educators, and missionaries around the world in a sincere effort to help others. These efforts have been undertaken by individuals, religious and social organizations, charitable associations, and the government. As believers in voluntarism and limited government, it is inappropriate for us to criticize how individuals freely spend their money. However, when the government coerces us through taxation to send aid overseas, we often have cause to object to the way our involuntary contribution is being spent on activities that appear unnecessary, wasteful, or even counterproductive.

Sometimes efforts to feed the starving prove well-intentioned, but sadly ineffectual. Even if the entire U.S. budget were directly distributed to the poorer half of the world's population, it would amount to less than $1,000 per person, certainly not enough to cure global poverty. Of course, with both our own bureaucracy and that of the recipient nation serving as intermediaries, a lot of that $1,000 would never reach the poor, but would instead support a small army of administrators, investigators, analysts, and auditors in both countries. If the recipient country's government were less than scrupulously honest, as is all too often the case, the poor would wind up with a couple of cups of milk and grain, while the U.S. government would be bank-

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rupt. After decades of receiving such aid, the recipient country would still be poor, and in fact there would be more poor people to feed in the future. One would hope that a better way to help these people would have been discovered by now.

Maximizing Employment

While we continue to be concerned about the poor overseas, we also feel an obligation to ensure maximum employment of our own citizens. Unemployment is generally recognized as a significant problem, for both personal and social reasons. Given current law, the financial drain the unemployed place upon society through the wide range of "compensation" and support programs is also of growing concern. While in most cases, the value of the welfare benefits an individual can receive is less than working wages, welfare pays well enough to support many people for extended periods of time. As government regulations and compensation plans directly and indirectly increase the cost of labor, and commensurately decrease the average worker's net pay, more and more businesses find it less profitable and more difficult to hire workers. Thus, unemployment, like global poverty, seems unlikely to disappear, despite the growing expenditures attempting to combat it. The more the government spends and regulates, the fewer people can be hired by private enterprise.

A popular scapegoat for unemployment in the United States (and in many other "industrialized" nations) is the "trade deficit." Many people, especially manufacturers and unionized workers, see imported vehicles, electronics, machine tools, and textiles flooding our markets and "taking away" sales from American manufacturers. These lost sales translate, they contend, into reduced production requirements, and ultimately lost American jobs. The fact that imported goods create sales, financing, service, and other related employment is generally ignored, because domestic industrial workers and manufacturers are far better organized, have more political clout, and are much more vocal. The result is a periodic frenzy of proposals to "protect American jobs and industry" through tariffs and quotas intended to limit or eliminate imports. As natural and unavoidable consequences of such moves:

- the cost of a given item to the American consumer rises due to the higher cost of producing the American product and the loss of competitive pressure on prices;
- consumers have less choice and fewer products available for purchase, reducing the incentive to increase earnings;
- the overall strength of the American economy falters as consumer spending drops in response to rising prices;
- Americans involved in buying and selling imported goods would be faced with significant losses and possibly unemployment;
- foreign manufacturers lose business, resulting in higher unemployment, lower tax revenues, and higher government spending in foreign countries;
- foreign individuals, corporations, and governments have fewer dollars to buy U.S. goods and services, or to pay off their heavy debt burdens; and
- growing economic problems in foreign nations often lead to

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political instability and increased anti-Americanism, increasing requirements for non-productive defense spending both overseas and in the United States.

Protectionism, like any other form of government intervention in economic life, has a cost. Government tariffs and quotas transfer money to certain people who have invested in, manage, or work for, industries that aren't competitive on their own merits. This forced transfer guarantees these firms that they will have a greater market share than they would have had without protection from competition. Without facing the pressures of the free market, they can continue to produce more expensive, less desirable goods, knowing their market cannot be taken by foreign competitors. Thus, the consumers (which often include the people benefiting from the protection) pay for protection—they get less, and pay more.

Protectionism Costs Consumers Billions

How much do we pay, as consumers, for protection of a few industries? Michael Munger, in "The Costs of Protectionism," estimates the total burden (in 1980 dollars) to be over $58 billion, and it is probably even greater today. Nearly a third of that cost was in the textile and apparel market, a burden that fell most heavily on the poor, who tend to buy the least expensive clothing that doesn't look cheap. They tended to favor foreign-made goods because they looked good, and didn't cost as much as American-made items. This value differential existed despite the tariffs and quotas involved, but it was greatly reduced. While the more affluent could afford the higher prices or even switch to American products, the poor were faced with buying less.

Apparel, Textiles

$18.3 Billion

Six billion dollars worth of tariffs and other barriers were applied to agricultural products, another area where the poor pay the cost for protectionism. On the other hand, protecting the jobs of highly-paid auto, steel and machinery production workers (and their employers) accounted for $26 billion in added protection costs. These costs affect all of us in a myriad of ways, because higher-priced transportation and manufacturing equipment raises the cost of all commodities to the consumer. Since these indirect costs are not included in the $26 billion, the true cost of protectionism in this segment of the economy could in fact be far higher.

Despite the "chance to modernize and catch up" that protection was supposed to offer these industries, most of them have chronically cried for protection against imports for decades. Only the threat of protection being phased out forced automakers and some steel manufacturers to begin modernizing. Some still haven't, and are slowly crumbling despite protection. The loss of employment in various aspects of importing and exporting goods is another unknown cost.

Footwear

$ 3.5 Billion

Another common cause of pleas for protection is the accusation that foreign states are selling goods in the U.S. at a price lower than it costs the foreign manufacturer to produce it. This practice, known as "dumping," is more often a reflection of some economist's incorrect analysis of the cost of production of a given item, rather than an example of some competing nation's attempts to undermine our economy. True "dumping" results in the "dumper" losing money on every piece sold, while the recipient, an American consumer, has saved money

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"A global trade war would have disastrous consequences at home, and could create enormous security problems for us abroad. As reliant as we are upon free trade, the rest of the world is even more dependent on it . . ."

that can be invested elsewhere. True "dumping" will ultimately bankrupt the "dumper."

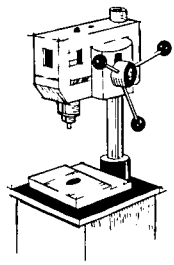
Even when Communist bloc nations with their controlled economies "dump" goods in the West to obtain hard currency, they are doing even more damage to their already inefficient, stifled economies. If they manage to temporarily "corner" a market, they will still have to provide equivalent goods at the same low prices, or face the re-entry of Western firms into competition with them. Despite the rock-bottom pricing structure subsidized by the various Eastern European governments, Russian "Ladas," "Polski Fiats," and Czech "Skodas" have not cornered the relatively open automobile market in Canada or Switzerland. Due to their greater economic efficiency, the Japanese and South Koreans provide far better cars for only a little more money. All "dumping" provided the Communists was a chance to subsidize the poorest segment of the Canadian auto market.

The French economist and legislator Frederic Bastiat recognized the fallacy of protectionism in the 1840s. He often resorted to satire to illustrate the absurdity of being preoccupied with maintaining a "favorable balance of trade." One of these was so believable that many thought it was a good example of the benefits of protection!

> A French merchant shipped $50,000 worth of goods to New Orleans and sold them for a profit of $17,000. He invested the entire $67,000 in American cotton and shipped it back to France. Thus, the customhouse record showed that the French nation had imported more than it had exported—an *unfavorable* balance of trade. Very bad.
>
> At a later date, the merchant decided to repeat the personally profitable transaction. But just outside the harbor his ship was sunk in a storm. Thus, the customhouse record showed that the French nation had exported more products than it had imported—a *favorable* balance of trade. Very good. Additionally, more jobs were thereby created for shipbuilders.
>
> Since storms at sea are undependable, perhaps the safest government policy would be to record the exports at the customhouse and then throw the goods into the ocean. In that way, the nation could guarantee to itself the profit that results from a favorable balance of trade.

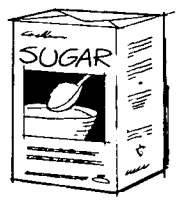
That economic disaster results from trade restriction and protectionism is not just theoretical speculation, however. The events of the period between 1922 and World War II illustrate them very graphically. The mid-1920s was a period of generally increasing prosperity. How-

Machinery



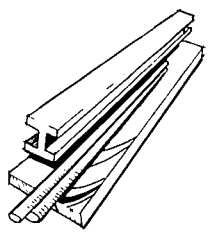
$10.9 Billion

Sugar



$ 2.7 Billion

Iron and Steel



$ 5.7 Billion

Source: *The Costs of Protectionism*, Center for the Study of American Business, by Michael C. Munger, 1983.

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Free trade promotes peaceful relations between nations. BETTINA BIEN GREAVES

ever, then as now, the rapid changes in economic organization, management and technology had severe impact on a few outdated industries that relied heavily on manual labor, and hurt those farmers who were still using nineteenth-century techniques.

Jude Wanniski, a former member of the *Wall Street Journal*'s editorial staff, wrote a book entitled *The Way the World Works*. He describes the manner in which the beleaguered "low-tech" manufacturers and farm lobbyists pushed through the infamous Smoot-Hawley tariff act. The idea of keeping out foreign competition sounded good to the news media, but it terrified the bankers and investors of Wall Street. When it appeared certain the bill would be passed, the stock market panicked. The result was the stock market crash of the autumn of 1929, followed by the Depression that was fueled by the general collapse of world trade. Consumers in America and the rest of the world were forced to buy inefficiently produced domestic goods, or pay extortionate prices for foreign ones. Foreign governments of course retaliated in kind, many having already begun economic warfare against the rest of the world. Markets for American goods dried up, investment collapsed, businesses failed, jobs disappeared.

Despite the popular belief that laws passed since 1929 could prevent another Great Depression, it *could* happen again. America is far more dependent upon imports and exports today than it was in the 1920s. A global trade war would have disastrous consequences at home, and could create enormous security problems for us abroad. As reliant as we are upon free trade, the rest of the world is even more dependent upon it, even though they may not recognize it. A collapse of world trade would hurt virtually all of our allies, and threaten the survival of many developing nations barely able to avoid default on their debts.

If one looks at things from a sufficiently broad perspective, one begins to see a major contradiction in our foreign policy. On the one hand, we want to help the poor overseas, and try to do so at great

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expense, but with limited success. We spend great sums of money to help defend foreign nations from present and potential enemies. Yet, on the other hand, we are willing to threaten the economic and political stability of these same nations (and our own) by creating insurmountable walls against their ability to freely sell goods in the world's richest market—the United States. This is a significant and costly inconsistency.

We have sent aid money to strengthen the economies of countries such as Japan, Thailand, Israel, Italy, Turkey, South Korea, and West Germany (to name a few). If these nations are to develop strong economies, they will naturally try to export goods to the United States and other nations. Yet, our response is to consider tariffs to shut out their products—threatening the same economies we ostensibly wanted to develop. The consumer ultimately pays the bill for all of this. They pay taxes to support efforts aimed at creating productive enterprises overseas, and pay higher prices (and have less free choice) because of attempts to protect American businesses against competition from overseas. And, as the ultimate blow to the budget and good sense, we pay to defend the same nations that supposedly "threaten" American jobs and profits.

The Benefits of Free Trade

Americans sincerely want to help people overseas. The question has become *how* to help them to the greatest extent while spending the least of our own hard-earned money. We also care about the health of our economy. Once again, the question is *how* to help preserve U.S. economic prosperity without disrupting international trade and causing ever-higher prices. The best method for accomplishing both goals is through free trade!

Why free trade? A basic economic reality—buying the best goods at the lowest prices—makes free trade more economical than closing our markets to foreign competitors. American consumers (all of us, including businesses and unionized labor) benefit by obtaining more goods for less money, while the foreign manufacturers and workers benefit by having jobs, making profits, and paying taxes to governments which then have a better chance to pay off their enormous debts. This, in turn, will make American banks more secure.

Free trade allows consumers around the world to buy more for less, which in turn creates more revenue for businesses. Governments have less call to provide tax-supported benefits to individuals or businesses, thus relieving the need to continue increasing taxes, inflation, or deficits. Ultimately, free trade will allow all but the poorest, least educated, and least diligent nations to get ahead. Examples of this are easy to find.

The most successful of the developing countries, states such as Singapore, the Republic of Korea, Republic of China (Taiwan), and Hong Kong, have built themselves up from illiteracy and poverty largely due to their respect for the power of free trade and relative economic freedom. Potentially wealthy developing nations, such as China, Brazil, Argentina, Nigeria, and Mexico, have stifled their own economic development through confused myriads of protective tariffs, import quotas, and centralized government manipulation of the economy.

Free trade also helps Americans and our trading partners overseas increase national security against both invasion and subversion. Open

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Free trade is a sound basis for relations between free nations. It is the best type of foreign aid. And it is good for American consumers.

trade tends to improve the economic health of all trading nations. These nations tend to be more stable internally, since strong economies generally result in reduced unemployment, greater availability and affordability of food, clothing, and other commodities, and relief from the sense of desperation felt by people barely able to survive—a desperation that often leads to disorder and revolution. These increasingly self-sufficient nations also are better able to defend themselves against invasion. Their industries are strong, their people are more confident, and they are able to obtain necessary imported supplies easily. Thus, nations dedicated to free trade tend to be more valuable as friends and allies, and less of a liability needing continuous costly support and military assistance.

If this sounds too easy, too good to be true, just reflect on the benefits we gained in our own country by the elimination of trade restrictions between the colonies/states after the adoption of the Constitution. Free trade allowed for better direction of local economic activity. New Englanders didn't have to struggle to be self-sufficient in agriculture on their rocky soil, while Southerners could freely purchase better, less costly tools and machinery built in large New England and mid-Atlantic factories. Entire new industries developed to support this commerce, as evidenced by the growth of banks and by the flurry of railroad, steamship, and canal companies that were formed in the 19th century. While inflexible individuals and businesses may have suffered, the overall prosperity of all of the states increased dramatically, and employment grew rapidly despite the destruction of the Civil War and the influx of impoverished immigrants from around the world.

Free trade works, both in the context of international development and in ensuring greater domestic prosperity. It helps the poor and at the same time helps the working class, the middle class, and the wealthy. It works because it represents efficiency—from each according to his ability, to each according to his work (work in the scientific sense of energy expended that has a tangible result). Money is not wasted administering complex trade agreements, monitoring the "fairness" of international trade practices, or buying overpriced goods. Money is not involuntarily taken from taxpayers to subsidize inefficient American businesses or the poor overseas.

Open international trading relations, especially between private individuals and businesses, facilitates peaceful relations between nations. Warfare is often a costly, destructive, and unsuccessful means to acquire another nation's goods and services—trade is a far more efficient and mutually beneficial way to obtain the desired goal. Free trade is a sound basis for relations between free nations. It is the best type of foreign aid. And it is good for American consumers and investors. □

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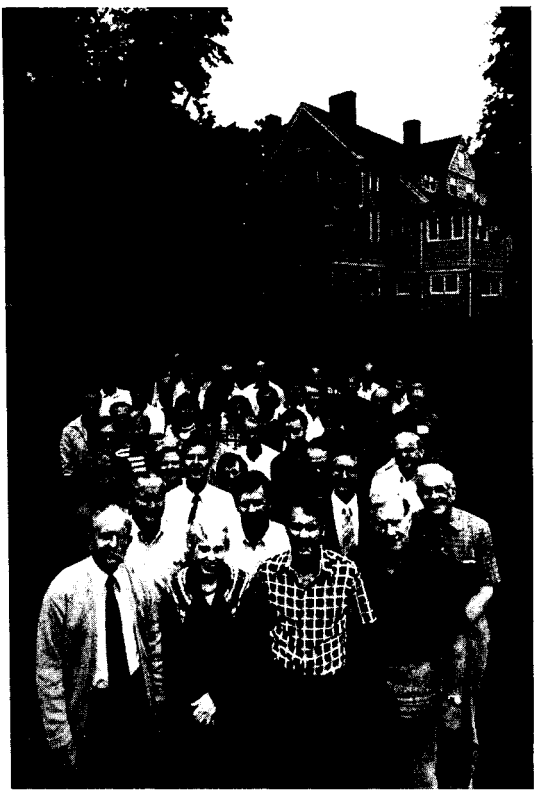
Individuals, companies, and foundations interested in furthering this educational enterprise are invited to attend or otherwise investigate the program and to assist with the financing of the fellowship grants.



The formal announcement, giving details of the seminars as well as information about fellowships, will be sent immediately on request.

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Liberalism

by John Chamberlain

When Ludwig von Mises wrote his *Liberalismus* (in German) in the Twenties, he was already worried about the title. As he was to observe much later in 1962, the tenets of nineteenth-century liberalism (free trade in a setting of limited government) had been pretty well forgotten on the European continent. In England, the Fabians were using the word "liberalism" to describe their slow-motion approach to socialism. And in America, the editorial policies of the weeklies that called themselves liberal (*The Nation, The New Republic*) favored all the interventionist ideas that would shortly become law with the coming of the New Deal.

Fearful that a literal translation of the original German title would be confusing, Mises, in 1962, called the English version of his book *The Free and Prosperous Commonwealth*. This was accurate enough in the context of Mises' assertion that freedom was menaced by every departure from the so-called "night watchman State," but Mises wasn't satisfied with it. Bettina Bien Greaves describes Mises' feeling that the word "liberalism" must be rescued from the collectivists. She quotes him as saying, in *Human Action*, that "there is simply no other term available to signify the great political and intellectual movement" that had fostered the free market economy.

So we come to the third edition of *Liberalismus*. It now bears the title of *Liberalism: In the Classical Tradition*. The translation is by Ralph Raico, and there are, in addition to Mises' own introduction to the 1962 edition, a new preface by Bettina Bien Greaves, and a foreword by Louis M. Spadaro of Fordham University. The book (208 pages, $9.95) is published by The Foundation for Economic Education (Irvington-on-Hudson, New York 10533) and the Cobden Press, 1800 Market Street, San Francisco 94102.

Liberalism represents Mises at his most positive. He had already explained in the early Twenties why socialism can't work. Without a price system based on the higgling of the market as individual traders go through the motions of buying and selling, there can be no way of calculating. Socialism can stagger along in Soviet Russia or middle way Scandinavia as long as there is a free world to the West to provide international price references. But when monetary calculation can't be applied to the grain trade, for example, nobody would know how much wheat to plant, or where, and even the production of hoes would have to be a matter of guesswork, to say nothing of such advanced things as reaper combines and tractors.

Mises gives full attention to this negative aspect of socialism in his *Liberalism*. But he is more concerned with the positive foundations of liberal policy. Leftists accuse liberalism of putting the interests of the propertied classes ahead of all other concerns. But this assertion, says Mises, is "completely mistaken." Liberalism had always had in view the good of the whole, as expressed in the Benthamite formula of "the greatest happiness of the greatest number."

Mises didn't think this formula was

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lib er•al•ism (lib er•al iz m), *n.*

The great political and intellectual movement that (1) substituted free enterprise and the market economy for precapitalistic methods of production, (2) established constitutional representative government in place of absolutism, and (3) promoted freedom for all individuals instead of slavery, serfdom, and other forms of bondage.

particularly well-phrased (it tries to multiply a quality by a quantity), but it does convey something. The early liberals tried to get away from the short-time promotion of special interests. Peel and Gladstone in England wanted to lower taxes to encourage a production that, in the long term, would benefit both workers and property owners. But, as the nineteenth century grew older, the anti-liberal parties grew stronger. They wanted tariffs to benefit specific manufacturers. The socialists among them wanted a steadily increasing welfarism. The rich must be made to pay for cradle-to-grave support of the poor, without regard to what this might do to the capital formation needed to create more jobs.

Mises doesn't name names in *Liberalism*. But his gift for clear abstraction will enable the 1986 reader to make the jump from the Twenties to modern times. His "parties of special interest" in the Twenties included the British laborites, the German social democrats, the French dirigistes, the fascists of various stripes, the Viennese socialists, the American "progressives" and farmer-laborites, and the union-oriented political bosses in the American big cities. In the Eighties there is a slight turn for the better. Fascism and Nazism have been discredited. In England, Margaret Thatcher has won something of a victory by breaking the stranglehold which the leftist coal miners had on British energy policy. In America, there are so-called supply siders in both major parties. Republican Congressman Jack Kemp can agree with Democratic Senator Bill Bradley that something must be done for the investment system as a whole by cutting high marginal tax rates.

Mises puts it all in a paragraph when he says "liberalism has demonstrated that the antagonism of interests, which, according to a widely prevalent opinion, is supposed to exist among different persons, groups, and strata within a society based on private ownership of the means of production, does not in fact occur. Any increase in the total capital raises the income of capitalists and landowners absolutely and that of workers both absolutely and relatively . . . The interests of the entrepreneurs can never diverge from those of the consumers."

When Mises was writing in the Twenties, Bolshevik Russia was the poorest power in the world. Mises would have left the Russians to try to make up for their deficiencies on their own. "Let the Russians be Russians," he said. "Let them do what they want in their own country. But do not let them pass beyond the boundaries of their own land to destroy European civilization . . . the governments of Europe and America must stop promoting Soviet destructionism by paying premiums for exports to Soviet Russia and thereby furthering the Russian Soviet system by financial contributions. Let them stop propagandizing for . . . the export of capital to Soviet Russia."

The Mises advice is still good. But it must be extended a bit to include the denial of help to such Communist outposts as Castro's Cuba and Ortega's Nicaragua. Liberalism has no business propping up its enemies. □

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Competing Visions
by Richard B. McKenzie
Cato Institute, 224 Second Street, SE, Washington, D.C. 20003 • 216 pages, $8.95 paperback

Reviewed by Joseph S. Fulda

Richard McKenzie's *Competing Visions* is a Cato Institute study of the fallacies of national industrial policy being urged on us by an increasing number of economists, intellectuals, and politicians.

McKenzie begins by surveying the varied proposals that fall under the rubric of national industrial policy. All of them have in common the view that America has undergone and continues to undergo severe deindustrialization avoided by other nations (notably Japan) only because of national industrial policy (NIP). Through careful analysis of data on the manufacturing sector, McKenzie shows that the doomsayers' positions on deindustrialization are either misleading, overstated, or both. NIP enthusiasts forget or do not mind that "government control of capital ultimately translates into control of people, whether the control is instituted by democratic or by authoritarian means." Also misleading, overstated, or both is the displaced worker myth and the inevitable proposals for government retraining programs.

One proposal virtually all NIP advocates call for—and the centerpiece of many of the bills introduced in Congress—is the reinstitution of the Reconstruction Finance Corporation. As McKenzie shows, however, the old RFC is "hardly a model to be followed." The original RFC was marked by "years of scandals" with "funds . . . often allocated on the basis of political friendship and bribery." Moreover, after its abolition, pieces of the original RFC continued to exist in various government agencies, none of which can be credited with economic success.

The Chrysler bailout, "touted as the quintessential example of what" an NIP might do, deserves special attention. As McKenzie quotes Heritage Foundation scholar James Hickel: "Chrysler has renegotiated its debt and restructured its organization in a way that greatly resembles a company that has gone through bankruptcy." Indeed, for all practical purposes, "the Chrysler Corporation *has* gone bankrupt" (emphasis added). McKenzie then presents an analysis showing that in all likelihood, the bailout aided stockholders and lenders, but saved no jobs. Even Chrysler's current success is questionable. Various accounting methods, unsound managerial decisions favoring short-term profits over long-term growth, and continued government protection all contribute to the appearance of success.

McKenzie then departs from his empirical approach to present a chapter on "the fatal conceit" of centrally managing an economy. His arguments derive from and are credited to Hayek, although they lack Hayek's rhetorical elegance and force. Tripartite councils consisting of key politicians, industrialists, and union officials, McKenzie assures us, could never duplicate the efficiency and justice of the market system.

Much of the concern motivating the industrial democracy movement stems from the desire of its proponents to ensure greater job security for workers. They justify such security with the language of individual rights. Workers, they say, have a right to their jobs. Well, that is one position that *Competing Visions* thoroughly explores, both philosophically and economically. The discussion is nothing short of brilliant and it is left for the reader to enjoy.

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Other topics discussed at length are capital mobility and taxation, the various forms of protectionism, their rationales, and the fallacies that undergird them.

McKenzie closes his study with a "competing vision," a view opposite to that of the NIP enthusiasts. "The case against managed capitalism," McKenzie writes, "is actually a set of arguments for constraints on the economic powers of government." Government must be barred, he warns, from the market function of picking "winners" and "losers." "That is the kind of economic future we must seek in order to remain prosperous and free." □

Discovery and the Capitalist Process
by Israel M. Kirzner

The University of Chicago Press, 5801 S. Ellis Avenue, Chicago, Illinois 60637 • 1985 • 192 pages, $22.50 cloth

Reviewed by Brian Summers

Government creates barriers. In a market economy, it sets up barriers against fraud and coercion, so that people can go about their peaceful affairs without let or hindrance. Interventionist government, however, creates barriers which tax, regulate, subsidize and generally hinder peaceful exchange.

What are the economic effects of such government interventions? At first glance, the consequences seem clear. Tax something and you get less of it. Subsidize something and you get more of it. Set up barriers to entry and you have less competition.

On this basis alone, economists have made compelling arguments against government intervention. By examining incentives, supply and demand, and the availability of investment capital, they have shown that tariffs, regulations, and other barriers to free exchange can only harm consumers.

But underlying much of this analysis is the troubling assumption of perfect knowledge. For example, to delineate how people will react to a given set of incentives, most economists assume that people are completely aware of all their options. In the real world, of course, such assumptions are overly heroic, thus raising serious doubts as to the real world applicability of most economic analysis.

Professor Israel M. Kirzner of New York University addresses these questions in *Discovery and the Capitalist Process*. Kirzner, long noted for his pathbreaking work on entrepreneurial alertness, shores up the economic defenses of capitalism, while providing fresh insights into the market process.

Suppose, for example, an entrepreneur discovers a new use for tin. Standard economic theory tells us that entrepreneurs will tend to stop using tin in old, low-valued ways, and shift it to more highly valued uses. In this way, consumers are best served by the market process.

But why did the entrepreneur perceive the new use for tin in the first place? And why, in a world of imperfect knowledge, did his competitors notice his discovery and adapt their behavior accordingly?

The answer, according to Dr. Kirzner, is the heady scent of profits. People tend to notice what it is in their interest to notice. When they are free to pursue profits, they tend to notice discoordinations in the market, and move scarce resources to more highly valued uses. Freedom is not only essential for efficient production, it is also needed for entrepreneurs to first perceive that efficient production is possible at all.

By the same token, the absence of freedom prevents entrepreneurs from first perceiving that scarce resources may, in fact, have more valued uses. Thus, the total cost of a government intervention is not only immeasurable, it is also unimaginable, because

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no single mind or group of minds can perceive the opportunities which, in a very real sense, are hidden by the barriers of intervention.

It is difficult to assess the full impact of Dr. Kirzner's work. For the economist, he has helped remove the crutch of perfect knowledge, and thus brought economic analysis one step closer to the real world. For public policy analysts, he has provided a richer, deeper understanding of the consequences of government intervention. And for students of liberty, he has provided a firmer foundation for free market economics. □

(Discovery and the Capitalist Process is available from The Foundation for Economic Education, $22.50 cloth, postage paid on prepaid orders.)

Ludwig von Mises

LIBERALISM:
IN THE CLASSICAL TRADITION

LIBERALISM: In The Classical Tradition by Ludwig von Mises is a book-length essay that sums up the ideas and principles of classical liberalism as they apply to the twentieth century. First published in Germany in 1927, it was published in the United States under the title *The Free and Prosperous Commonwealth* in 1962 and reissued in the mid-seventies by The Institute for Humane Studies. It has just been republished by The Foundation for Economic Education in association with the Cobden Press.

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Free vs. Unfree

Over the years, FEE's activities have earned my trust. But it is much more than trust alone. FEE's activities, particularly *The Freeman*, are a source of inspiration and hope for the future. South Africa must be one of the most over-governed countries around, with an entrenched statist regime. The writings from the Foundation have given me much ammunition in my, albeit small, "fight" for a free society.

The task ahead is immense, almost overwhelming, but the work to restore our liberty must go on. In South Africa the politicians would like us to believe the "battle lines" lie somewhere between the white and the black communities (or sometimes between Communist and Christian). But this is not so. The division is between those people believing in a free society and those supporting a regulated one—I suppose, as in most countries. Yet there are already many signs pointing the way to a better South Africa. There is much hope for the future. May the Foundation continue to prosper and carry on the good work.

Walter Kassier
Wandsbeck
Rep. of South Africa

Tribute to Mises

It was a pleasure to attend FEE's recent seminar on liberalism (November 2–3) and to read the symposium on *Liberalism* by Ludwig von Mises in *The Freeman* (November). Mises was indeed a man alone, a heroic battler on a barren intellectual landscape. His intellectual ability was remarkable, as was his unconquerable spirit and his uncompromising persistence in advocating his principles despite overwhelming odds. He was, as speaker Ralph Raico pointed out, a man who "could do no other."

The seminar's distinguished speakers paid eloquent tribute to both the economist and the man, but most moving of all were the taped remarks of Margit von Mises. Mrs. Mises observed that her husband was a "great humanitarian" who "lifted economic science out of a materialistic rut." Mises "challenges the reader—not only to understand the economic principles involved in human action, but also to realize the full meaning of human action in terms of human welfare, and the fatal results for humanity if that lesson is not learned. All through his writings there is glowing evidence of his concern for his fellow human beings. . . . And there was always a challenge in his books for the readers to display the same persistence and courage that he himself displayed throughout his whole life."

This FEE seminar both intensified its participants' thirst for knowledge, and inspired them with an exemplar of human greatness.

David M. Brown
Syracuse, New York

Liberalism: "Old" and "New"

I read with considerable interest the symposium section in the November *Freeman*, "Classical Liberalism Reconsidered." I found the various pieces quite instructive. I was surprised at one thing, however. Although the contributors clearly noted that "old-style" (19th century) liberalism is quite different from contemporary liberalism, the character of the change was not mentioned as clearly as it might have been.

The main distinction between "old" and "new" liberalism can be stated simply: classical liberalism emphasized the importance of liberty, whereas today's liberalism is equality-centered, or egalitarian in character.

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Of related significance is the fact that classical liberalism sought to protect the individual from *government* tyranny, whereas modern liberalism generally seeks to protect individuals and groups from *social* injustice.

Precisely at what point "liberalism" began to change its emphasis is not clear to me, but two transition periods in the present century deserve careful consideration: the Progressive Era and the New Deal. One possible clue to this change in emphasis might be to notice which of our nation's political leaders have been commonly described as "liberal" in their day.

Michael Bordelon
St. Thomas' Episcopal School
Houston, Texas

A Liberal Social Order

The Freeman is to be commended for its recent symposium on classical liberalism. In particular, it is to be applauded for bringing to the attention of its readers the single best book on the subject—Ludwig Mises' brilliant, but sadly all too often neglected, *Liberalism*.

The lesson taught us by Mises and his most famous student, F.A. Hayek, is that what is essential for the vitality and the cohesion of the free market social order is the free interplay of the *unintended* effects of freely chosen entrepreneurial and exchange activities of market participants. It is these unintended or second order effects that create an understandable and systematically functioning social order out of what otherwise might be seen as unrelated and, perhaps, even seemingly chaotic behavior.

The liberal social order needs no overseer, no outside planner, director or coordinator. The hallmark of liberal social theory was to recognize that the free society has *within* it a superbly sophisticated adaptive process which ensures its continuing self-ordering and system-wide coordination. Any coercive intervention into this free exchange process will lead only to a breakdown in social order and cohesion which is the very opposite of the benign, self-ordering, unintended effects produced by the freely operating voluntary exchange process.

To waver from this insight and from these fundamental principles is to risk the collapse of any civilized, humane, just, and prosperous social order. This is why it is so important that *The Freeman* continue its comprehensive and unrelenting advocacy of the freedom philosophy.

Walter Grinder
Institute for Humane Studies
Fairfax, Virginia

Much to Learn

I like the idea of letters to the editor very much and read them first when the November issue arrived. Unlike Robert T. Smith, writing in the November issue, I don't try to read all the articles at one time but take them slowly and thoughtfully, often marking and underlining some phrases and paragraphs that I feel are especially significant. I have learned much that way and I further expect to learn something from the "Letters."

Bob LeFevre used to write a brief comment to each letter he printed in his journal and I think this practice might enhance your new endeavor. It produces an interesting dialogue.

My best wishes for your continued success.

Ewald H. J. Stechholz
Rockville, Connecticut

Let us hear from you! We will share with readers the most interesting and provocative letters we receive. Letters may be edited for purposes of clarity or space. And opinions expressed are not necessarily those of *The Freeman*. Address your letters to: To the Editor, *The Freeman*, The Foundation for Economic Education, Irvington-on-Hudson, New York 10533. □

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Ideas on Liberty

A new public opinion must be created privately and unobtrusively. The existing one is maintained by the press, by propaganda, by organization, and by financial influences which are at its disposal. The unnatural way of spreading ideas must be opposed by the natural one, which goes from man to man and relies solely on the truth of the thoughts and the hearer's receptiveness for new truth. . . .

ALBERT SCHWEITZER

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. . . I am for doing good to the poor, but I differ in opinion about the means. I think the best way of doing good to the poor, is, not making them easy in *poverty, but leading or driving them* out *of it.*

—BENJAMIN FRANKLIN

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